5 February 2014

SATS Ltd.

Exposure to regional travel growth story

SINGAPORE | TRANSPORTATION SERVICES | RE-INITIATION

Rating: Accumulate

(Maintained at Accumulate)

Target Price (SGD)	**3.47**
Closing Price (SGD)	3.13
Potential Upside	**16.3%**

- Exposure to regional aviation growth story.
- Riding the wave of international cruise passengers.
- Attractive dividend yield of 5.4%
- Re-initiate coverage with Maintain "Accumulate", with a revised TP of S$3.47 based on DCF (WACC: 6.0%, Terminal g: 0.5%).

Following a change of analyst, we re-initiate coverage on SATS Ltd. with Company Background and Industry Analysis attached in the Appendix of this report.

What is the news?

- Release of 3QFY2013-14 Operating Statistics for Singapore Aviation Business
- Infrastructure works underway at Changi Airport to double existing passenger handling capacity to 135 million by mid-2020s. Construction of Terminal 4 has commenced and mixed-use complex Project Jewel announced.
- SATS pending acquisition of Singapore Cruise Centre (SCC).
- SATS expands into institutional catering with Sports Hub

How we view this

3Q FY2013-14 Operating Statistics for Singapore Aviation Business – Gateway operating metrics grew, inline with estimates, but gross and unit meals declined y-y, mainly due to loss of Qantas' flights on the Europe route.

Changi Airport – Being the dominant player at Changi Airport we are positive on SATS reaping the benefits of the growth in passenger traffic at Changi Airport through both its Gateway services and Food solutions businesses.

Singapore Cruise Centre – SCC is a profitable and strong cash-generating business which will be immediately EPS accretive to SATS. Shareholders can look forward to a higher EPS. SATS will also be in a position to promote Singapore as a home-port for cruise operators, with potential further growth in revenue. Though management expects cruise passenger throughput to grow above CAGR 6.5%, we have conservatively not baked this into our forecasts yet.

Sports Hub – Management expects S$50mn of revenue a year from catering.

Investment Actions

We continue to be positive on SATS due to: (1) Changi Airport maintaining its position as the premier regional aviation-hub; with strong growth forecast in flight and passenger numbers, (2) Foothold in cruise Gateway services, tapping on growth in cruise passenger throughput, (3) Exclusive caterer at the Sports Hub, (4) Attractive dividend yield of 5.4%. We re-initiate coverage on SATS and derive a TP of S$3.47. We maintain our Accumulate rating.

Key Financial Summary

FYE Mar	FY11	FY12	FY13	FY14F	FY15F
Revenue (SGD mn)	1,358	1,685	1,819	1,814	2,052
NPAT, adj. (SGD mn)	179	181	202	214	244
EPS, adj. (SGD)	0.17	0.15	0.17	0.19	0.23
P/E (X),adj.	12.0	14.6	17.7	16.4	13.7
BVPS (SGD)	1.46	1.46	1.35	1.38	1.43
P/B (X)	1.4	1.5	2.2	2.3	2.2
DPS (SGD)	0.17	0.26	0.15	0.17	0.21
Div. Yield (%)	5.4%	8.3%	4.8%	5.4%	6.5%

Source: Bloomberg, PSR est.

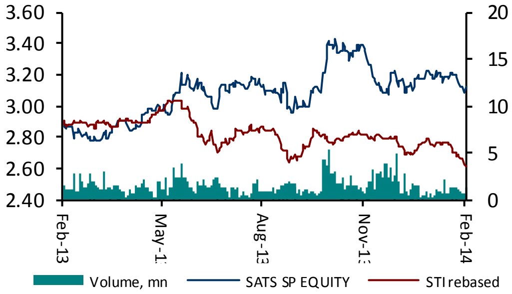
*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.

Company Description

SATS Ltd. provides Gateway Services & Food Solutions, with a dominant presence in Singapore Changi Airport. The Group also has a network of JVs across Asia and holds a majority stake in TFK Corp, an in-flight catering business based in Japan.

Company Data

Raw Beta (Past 2yrs weekly data)	0.26
Market Cap. (USD mn / SGD mn)	2767 / 3510
Ent. Value (USD mn / SGD mn)	2629 / 3337
3M Average Daily T/O (mn)	1.46
Closing Px in 52 wk range	2.86 – 3.53



Major Shareholders	**(%)**
1. Temasek Holdings Pte Ltd	42.9
2. Mondrain Investment Partners Ltd	5.0
3. Capital Group Companies Inc	2.8

Valuation Method

DCF (WACC: 6.0%, Terminal g: 0.5%)

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Re-initiation of coverage

Following a change of analyst, we re-initiate coverage on SATS Ltd. with **Company Background** and **Industry Analysis** attached in the **Appendix (Page. 13)** of this report. I**nvestors unfamiliar with SATS may want to read the Appendix first**.

Investment merits

- Exposure to air travel demand: Passenger traffic at Singapore Changi Airport grew at CAGR of 5.4% over the last decade and expected to double by 2020.
- Riding the wave of international cruise passengers: SATS expects cruise passenger throughput to grow at CAGR of above 6.5%.
- Growing EPS with 5.4% dividend yield

Our outlook for SATS by business segments

Aviation Gateway services and Food solutions at Singapore Changi Airport – We remain positive on the outlook for SATS's operations at Changi Airport that it will benefit from the growth in air traffic and passenger traffic. Efforts by the Government and Changi Airport Group to increase passenger handling capacity can be used as a proxy to forecast the volume of air traffic expected at Changi Airport.

We also did a survey on the aircraft backlog orders of the airlines operating at Changi Airport. (Refer to **Table 1.**, **Page 8**). We see many of the airlines operating at Changi Airport have placed orders with both Boeing and Airbus, and that there is a heavy backlog in deliveries of the aircraft. We believe that this reflects the airlines' desire to aggressively renew their fleets and increase capacity in order to meet passenger demand; and that there are good prospects for growth in air travel.

As such, **we expect to see good growth in aviation Gateway services revenue for SATS in direct relation with number of flights handled**. Meanwhile, we are **less optimistic on the growth in aviation Food solutions revenue**, as we note that the growth in meals produced will not be equally robust as growth in passenger numbers. Growth in passenger numbers has been driven by demand for LCC flights and not the full-service flights; hence **meal volumes will not grow in lockstep with passenger numbers**.

SATS has released data on the Operating Statistics for their Singapore Aviation Business on Jan 20. We see that the number of flights handled has enjoyed strong 10.2% y-y growth, fuelled by the higher LCC traffic. Meanwhile, meal volumes dipped y-y primarily due to Qantas bypassing Changi Airport en-route to Europe.

Operating Statistics for Singapore Aviation Business

(SGD mn)	3Q14	3Q13	y-y (%)	Comments
Passengers Handled (mn)	11.3	10.7	4.8%	Higher LCC traffic
Flights Handled ('000)	34.9	31.7	10.2%	
Unit Services ('000)	28.6	26.9	6.6%	
Cargo ('000 tonnes)	384.3	377.2	1.9%	
Gross Meals Produced (mn)	6.6	7.2	-8.8%	Loss of Qantas' flights to Europe
Unit Meals Produced (mn)	5.3	5.6	-5.7%	Loss of Qantas' flights to Europe

Source: Company, PSR

TFK Corp. – Although TFK holds the biggest market share at Narita International Airport and Haneda Airport, but Management cited that competition in this region is keen as TFK is one of four players at Narita, and one of six players at Haneda.

%y-y revenue growth has been falling (refer to Fig. 5 showing the Quarterly revenue contribution from TFK to SATS) and is now -20.8% for the most recent 2Q14. Meal volumes produced by TFK have been weak due to recent cross-straits tensions. At present, we do not see any easing in Sino-Japanese tension in the near future. The situation remains volatile with recent developments of China flexing its military muscle (naval exercises and unilateral establishment of an overlapping Air Identification Zone), a potential shift in Japan's self-defence policy away from a Pacifist constitution, and the ever present nuclear threat from an increasingly unpredictable North Korea. The USA military has also been playing a cat-and-mouse-game to antagonise China's military both at sea and in the air. **We project meal volumes to not recover within the next three quarters to the peak values seen in 2Q of FY2012-13**.

We also note that TFK has an operating margin of about 3.6%, while that of SATS Group is about 10.6%; and that TFK is causing a drag on SATS's overall operating margin. We performed a comparables analysis on airport services peers in Japan and Korea and found that the Japan and Korea regions appear to exhibit the same weaker operating margins compared to SATS Group. (Refer to following Table)

Table 2. Operating Margin

Company	FY08	FY09	FY10	FY11	FY12	FY13
SATS Ltd.	18.4%	15.9%	12.1%	12.4%	9.9%	10.6%
TFK Corp.	-	-	-	(2.2%)	0.1%	3.6%
JAPAN AIRPORT TERMINAL CO	5.5%	4.8%	4.2%	3.1%	0.7%	3.1%
KOREA AIRPORT SERVICE CO LTD	5.0%	5.7%	4.7%	5.0%	4.4%	-

Source: Bloomberg, PSR

Further analysis reveals that TFK's weaker operating margin is due to the significantly higher Staff Costs and Cost of Raw Materials as compared to the main SATS Group. SATS has ceased to provide expenditures breakdown from 1Q14 onwards, hence the data is only up to FY13. (Refer to following Table.)

Table 3. Comparison of expense margins

	TFK Corp.			SATS excluding TFK Corp.		
	4Q11	**FY12**	**FY13**	**4Q11**	**FY12**	**FY13**
Staff Costs	47.1%	45.3%	44.3%	41.2%	40.5%	41.6%
Cost of Raw Materials	32.2%	32.7%	32.6%	20.3%	19.6%	19.1%
Licensing Fees	0.6%	0.5%	0.5%	4.8%	5.0%	5.1%
Depreciation & Amortisation	5.6%	5.8%	4.1%	5.7%	5.8%	5.3%
Company Premise & Utilities	8.1%	8.0%	7.4%	6.8%	7.2%	7.1%
Other Costs	8.5%	7.5%	7.5%	7.9%	9.7%	9.6%
Total	102.2%	99.9%	96.4%	86.7%	87.8%	87.9%

Source: Company Data, PSR

In view of the inherent cost structure of doing business in the Japan and Korea region, we do not expect to see any significant improvement in operating profit margin for TFK moving forward. However, we currently still view TFK favourably for the following reasons:

- Potential for strong turnaround when cross-straits tension ease, capitalising on strong travel demand from China.
- Operating synergy of serving existing customers plying in and out of Japan.

Non-aviation Food solutions – We do not see much opportunities remaining for SATS to substantially enlarge its existing share of the domestic market, as it is already the market leader. Further growth for SATS in this segment would likely have to come from new developments that add new opportunities to the existing domestic market. For example, the Integrated Resorts, the new Sport Hub, or other international events being held in Singapore such as the F1 night-race. With its long-standing expertise in large-scale food catering, SATS is well-positioned to seize opportunities and clinch catering contracts for such major developments. With the inclusion of the new Sports Hub operations, we **expect to see some boost in revenue starting from 1Q FY2014-15** when operations are scheduled to commence in April 2014. **Management guided that S$50 million in revenue is expected annually from the Sports Hub**.

Non-aviation Gateway services – SATS has managed and operated Marina Bay Cruise Centre (MBCCS) through its joint venture SATS-Creuers since May 2012. With the inclusion of MBCCS consolidated into SATS's financials, and the positive outlook on the growth of cruise passengers in Singapore, we expect to see some revenue growth to contribute to the total revenue of SATS.

In a press release by Ocean Shipping Consultants dated September 2013, it forecasted strong passenger demand for cruise up to 2025, with North America dominating but Asia Pacific region expected to grow strongly nonetheless. The press release further highlights the significant difference in economic impact between a port-of-call and a home-port; and that awareness of this difference has set in motion keen competition between ports to attract more vessel calls and ultimately home-port activity. The press release further stated that "Singapore and Hong Kong remain the region's main cruise centres, while China is expanding rapidly in cruise terminal activities, developing major home ports as well as ports-of-call."

Management guided that they are expecting above CAGR 6.5% in cruise passenger throughput up to 2017. **We view the growth prospects favourably and are optimistic, on condition that SATS-Creuers will be able to attract quality cruise-operators to ply their cruise-lines through Singapore and drum up interest from consumers**. There are opportunities for SATS-Creuers to form partnerships with other ports within the region to establish adequate infrastructure to entice more cruise-operators to the region.

Performance of associates and joint ventures – SATS has associates and JVs spanning various locations across Asia and the Middle East. These associates and JVs are engaged in various businesses, such as in-flight catering, passenger handling and freight handling. In a recent analyst luncheon hosted by SATS's CEO, optimism was expressed to leverage on SATS's regional network for greater returns. For the moment, we estimate this portion of SATS's investment to continue generating an average ROE of approximately 13% annually.

Key downside risks for SATS

1. Slowdown in global economy weighing entire aviation sector down.
2. Airlines choosing to by-pass Singapore, in favour of other aviation-hubs.
3. Natural disasters, health pandemics, civil and political unrests resulting in disruption of air-routes and food production supply-chain.
4. Expected growth in cruise passenger throughput fails to materialise.

Details on recent developments for SATS

Operating Marina Bay Cruise Centre Singapore (MBCCS) – Leveraging on their existing expertise in providing aviation Gateway services at Changi Airport, SATS has started providing cruise Gateway services at MBCCS. Its wholly-owned subsidiary SATS Airport Services had entered into a 60:40 joint venture with Creuers del Port de Barcelona to manage and operate MBCCS, under SATS-Creuers Cruise Services (SATS-Creuers). Operations at the terminal commenced in May 2012 and it is the **home port to seven ships as of FY2012-13 ended**. SATS-Creuers **handled more than 80 ship calls and over 230,000 passengers** during its first year of operations in FY2012-13.

SATS-Creuers' role as the operator of MBCCS is to provide: (1) Cruise terminal operations, (2) Passenger and baggage facilitation and (3) VIP lounge management. Sources of revenue are berthing fee per ship, disembarkation fee per passenger and rental income from retail outlets within MBCCS. As the Gateway services operator at both Changi Airport and MBCCS, SATS is able to aggressively promote its Cruise-Fly and Fly-Cruise services. The service offer seamless check-in and baggage handling for passengers arriving by ship and departing by air, or *vice versa*.

A notable feature of the MBCCS berths is that there is no height restriction imposed on vessels and they are able to accommodate some of the world's largest ships. This augurs well in the push to promote Singapore as a leisure cruise destination and to attract more ships to home-port at MBCCS.

Exclusive caterer at Sports Hub – The wholly-owned subsidiary SFI has entered into a 70:30 joint venture with Delaware North Companies to form Sports Catering Services. The joint venture was appointed in March 2013 as the **exclusive caterer to the Sport Hub**, providing hospitality and catering services for 21 years. Operations are expected to commence in April 2014, with earnings to accrue from 1Q FY2013-14 onwards. Management guidance is that S$50 million in revenue is expected annually.

Acquisition of Singapore Cruise Centre (SCC) – SATS has announced its intention to acquire SCC for S$110 million. SCC currently operates the four terminals located at three sites: HarbourFront Centre (International Cruise Terminal and Regional Ferry Terminal), Tanah Merah (Regional Ferry Terminal) and Pasir Panjang (Domestic Ferry Terminal). The Competition Commission of Singapore has completed Phase 1 review of the proposed acquisition, and Phase 2 review will commence upon receipt of Form M2 from the parties. The review process can take up to 24 weeks. Feedback from SATS management is that the From M2 has been submitted and Phase 2 is in progress.

We think that the acquisition will be good for SATS as it is in-line with the Group strategy of growing its core Gateway services business. SATS will also be able to synergise their aviation and cruise Gateway services to provide passengers with an unrivalled level of convenience for transfer, check-in and baggage-handling. As the acquisition will be paid out in cash and SCC is already profitable, we **expect to see an immediate increase in EPS**.

Re-cap on Government spending on infrastructure

Project Jewel & Terminal 1 – Announced in August 2013, Project Jewel is the project codename for the redevelopment of the existing 3.5-hectare plot of land fronting Terminal 1 currently serving as a car park into a mixed used complex. The complex will connect Terminals 1, 2 and 3 and house facilities such as a multi-storey basement car park, retail outlets and leisure attractions. **SATS will directly benefit from Project Jewel as there will be facilities dedicated to the Fly-Cruise passenger segment**, which SATS now serves since it began operating the MBCCS. The key objective of Project Jewel is to offer a unique experience to visitors, and entice travellers to choose Singapore a destination. **As part of Project Jewel, Terminal 1 will also be expanded to increase its current capacity of 21 million to 24 million passengers annually.** Project Jewel is expected to be completed by 2018.

Terminal 4 – Currently under construction at the site of the former Budget Terminal, the new Terminal 4 will be capable of handling both regional full-service carriers, LCC and **handling 16 million passengers annually**. Terminal 4 is slated to be completed by 2017.

Terminal 5 & three-runway system – A new mega terminal has been planned for Terminal 5, which will be one of the largest terminals in the world. It will be able to **handle up to 50 million passengers annually** and expected to be completed in mid-2020s.
A three-runway system is expected to be implemented by 2020. The existing Runway 3, currently used exclusively by the Republic of Singapore Airforce, will be extended from 2.75km to 4km to handle larger civilian aircraft. New taxiways and facilities will be included in the upgrading. The upgrading of the runway is to cope

with the anticipated increase in number of flights landing at Changi Airport.

Conclusion: We view these developments positively as it demonstrates the Government's commitment to maintaining Changi Airport's position as the premier regional aviation-hub, together with the upgrading of infrastructure to increase passenger handling capacity. SATS stands to benefit from the growth in passengers utilising Changi Airport, and the ability of the airport to cope with the expected growth in passenger numbers. (Table below summarises the schedule for Changi Airport's passenger handling capacity.)

Table 4. Expected passenger handling capacity (mn)

	CY 2014	CY 2017E	CY 2018E	mid-2020s
Terminal 1	21	21	24*	24
Terminal 2	23	23	23	23
Terminal 3	22	22	22	22
Terminal 4		16	16	16
Terminal 5				50
Total	**66**	**82**	**85**	**135**

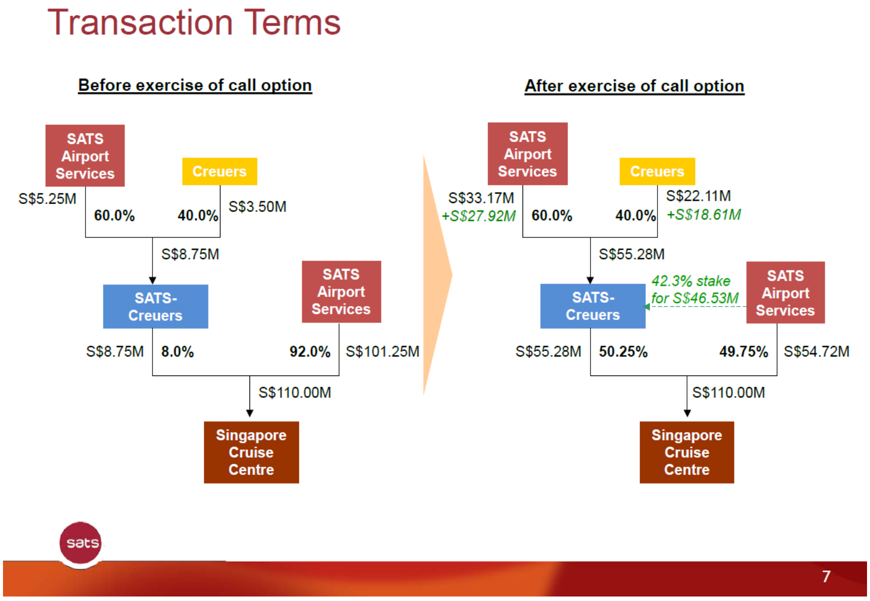
Source: Changi Airport Group, PSR
* Project Jewel, with Terminal 1 expansion

Future events to look out for

Acquisition of SCC and Exercise of option by SATS-Creuers – The acquisition of SCC by SATS Airport Services and SATS-Creuers is currently under Phase 2 review by the Competition Commission of Singapore (CCS). **We view that it is likely the CCS will approve the deal.** This will allow SATS-Creuers to consolidate its position as the incumbent cruise Gateway services operator locally, so that it can be in a better position to compete with other cruise terminal operators within the region. We believe that the authorities recognise that it is in the best interest for Singapore to bolster its position as a cruise-hub with a competent terminal operator, and encourage more cruise ships to make Singapore their home-port. There will be tremendous economic impact particularly for the local ship repair industry, when cruise ships make Singapore their home-port.

Following approval from CCS, an EGM will be convened to obtain shareholder approval for the deal as this is an Interested Person Transaction. Temasek Holdings and its associates will abstain from voting at the EGM.

Under the terms of the deal to acquire SCC, SATS Airport Services (92%) and SATS-Creuers (8%) will jointly own SCC. In addition, SATS-Creuers holds a **call option to purchase another 42.3%, exercisable by 31 March 2014**, to bring its total shareholding to 50.3**%. After exercise of call option, the SATS effective stake goes from 96.8% to 79.9% resulting in a marginal negative effect on EPS of 0.3 cents.**



Financial Effects of Proposed Transaction
(for illustrative purpose only)

SATS Group FY2012-13	Before Acquisition	Pro forma After Acquisition (Call Option Not Exercised)	Pro forma After Acquisition (Call Option Exercised)
Revenue (S$m)	1,819	1,864	1,864
Earnings Per Share (Singapore cents)	16.6	17.5	17.2
Net Tangible Assets (S$m)	1,119	1,032	1,047

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Source: SATS Presentation: "Acquisition of Singapore Cruise Centre", dated 26 Sept 2013

Effects of US Fed tapering and interest rates – We do not see this having an impact on SATS's ability to fulfil its debt obligations as the Company does not have a high gearing. The debt-to-equity ratio for SATS was a low 0.088 at end FY2012-13 and 0.086 at 2Q14. Furthermore, SATS is in a net cash position.

A rising interest rate environment is usually not good for dividend-play stocks such as SATS. However, SATS is showing both EPS and DPS growth, and this should partially mitigate the effects of the rising interest rates.

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Table 1: Airlines operating at Changi Airport with backlog orders

	Boeing backlog as of 31 Dec 2013					Airbus backlog as of 30 Nov 2013					
	737	747	767	777	787	A319	A320	A321	A330	A350	A380
Air China							1	2	9	10	
Air France							3				3
AirAsia							344				
All Nippon Airways	4			3						30	6
British Airways					18					18	9
Cathay Pacific Airways		4		24					8	46	
Cebu Pacific Air							15	30			
China Airlines										14	
China Eastern Airlines						6	14	12	10		
China Southern Airlines							10	15	4		
Delta Airlines								30	10		
Drukair						1					
Emirates										70	49
Etihad Airways				26	30		15	32	4	62	10
Finnair								3		11	
Garuda Indonesia							25		18		
Hainan Airlines									2		
IndiGo							173	20			
Japan Airlines										31	
Jet Airways									5		
KLM Royal Dutch Airlines				1							
Korean Air		5		6	1				6		2
Lion Air							169	65			
Lufthansa German Airlines				20			102	42	1	25	4
Malaysia Airlines									2		
Mandala Tigerair							25				
Philippine Airlines								38	15		
Qantas Airways	5						113				8
Qatar Airways				2			36	14	5	80	10
Shenzhen Airlines							5				
Sichuan Airlines						2	4	2			
Singapore Airlines					30				2	70	5
SriLankan Airlines									6	4	
Swiss International Air Lines				6				1	1		
Tigerair							11				
Turkish Airlines								78	19		
United Airlines	14				10	16	14			35	
Vietnam Airlines								8		10	
Xiamen Airlines					6						

Source: Boeing, Airbus, PSR

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FYE Mar	FY11	FY12	FY13	FY14F	FY15F
Income Statement (SGD mn)					
Revenue	**1,358**	**1,685**	**1,819**	**1,814**	**2,052**
EBITDA	**246**	**266**	**285**	**281**	**318**
Depreciation & Amortisation	(77)	(97)	(93)	(78)	(81)
EBIT	**169**	**169**	**192**	**203**	**237**
Net Finance (Expense)/Inc	(1)	(1)	(2)	(6)	(7)
Other items	2	13	(2)	0	0
Associates & JVs	47	41	53	51	54
Exceptional items	0	0	0	0	0
Profit Before Tax	**217**	**222**	**241**	**248**	**285**
Taxation	(37)	(37)	(40)	(33)	(39)
Profit After Tax	**180**	**185**	**202**	**214**	**246**
- Non-controlling interest	0	4	0	0	1
Net Income, reported	**191**	**171**	**185**	**214**	**244**
Net Income, adj.	**179**	**181**	**202**	**214**	**244**

FYE Mar	FY11	FY12	FY13	FY14F	FY15F
Per share data (SGD)					
EPS, reported	0.174	0.154	0.166	0.191	0.229
EPS, adj.	0.173	0.154	0.165	0.191	0.229
DPS	0.170	0.260	0.150	0.170	0.205
BVPS	1.46	1.46	1.35	1.38	1.43

FYE Mar	FY11	FY12	FY13	FY14F	FY15F
Cashflow Statements (SGD mn)					
CFO					
PBT	231	213	225	248	285
Adjustments	51	66	64	24	22
WC changes	(32)	(68)	(11)	1	(17)
Cash generated from ops	250	211	278	273	290
Others	(50)	(43)	(32)	(40)	(26)
Cashflow from ops	**200**	**168**	**246**	**232**	**264**
CFI					
CAPEX, net	(68)	(64)	(37)	(60)	(80)
Divd from associates & JVs	40	23	25	25	27
Others	(66)	265	(4)	(104)	2
Cashflow from investments	**(95)**	**225**	**(17)**	**(138)**	**(50)**
CFF					
Share issuance, net	30	0	8	18	20
Loans, net of repayments	112	(12)	(5)	(3)	(3)
Dividends	(144)	(188)	(289)	(167)	(191)
Others	0	(16)	0	0	0
Cashflow from financing	**(2)**	**(216)**	**(286)**	**(151)**	**(173)**
Net change in cash	**104**	**177**	**(57)**	**(57)**	**41**
Effects of exchange rates	(3)	(3)	(9)	0	0
CCE, end	**296**	**470**	**404**	**347**	**388**

FYE Mar	FY11	FY12	FY13	FY14F	FY15F
Balance Sheet (SGD mn)					
PPE	742	654	592	572	568
Intangibles	487	213	193	173	153
Associates & JVs	335	368	390	416	443
Investments	25	22	20	126	136
Others	44	35	28	37	45
Total non-current assets	**1,632**	**1,292**	**1,223**	**1,323**	**1,345**
Inventories	59	44	53	51	58
Accounts Receivables	303	294	301	340	385
Investments	0	0	0	0	0
Cash	304	472	406	347	388
Others	21	22	21	26	28
Total current assets	**688**	**831**	**780**	**765**	**858**
Total Assets	**2,320**	**2,124**	**2,003**	**2,088**	**2,203**
Short term loans	164	27	23	25	26
Accounts Payables	286	203	237	279	316
Others	44	42	51	50	57
Total current liabilities	**494**	**272**	**310**	**354**	**399**
Long term loans	21	131	109	121	128
Others	186	106	84	66	75
Total non-current liabilities	**207**	**237**	**193**	**187**	**203**
Total Liabilities	**700**	**510**	**503**	**541**	**602**
Non-controlling interest	99	106	97	97	97
Shareholder Equity	**1,521**	**1,508**	**1,403**	**1,451**	**1,504**

FYE Mar	FY11	FY12	FY13	FY14F	FY15F
Valuation Ratios					
P/E (X), adj.	12.0	14.6	17.7	16.4	13.7
P/B (X)	1.4	1.5	2.2	2.3	2.2
EV/EBITDA (X), adj.	9.3	8.6	10.8	12.1	10.6
Dividend Yield (%)	5.4%	8.3%	4.8%	5.4%	6.5%
Growth & Margins (%)					
Growth					
Revenue	-11.8%	24.1%	7.9%	-0.3%	13.1%
EBITDA	-10.5%	8.2%	7.1%	-1.4%	13.1%
EBIT	-8.4%	0.0%	13.8%	5.6%	16.9%
Net Income, adj.	-1.0%	0.9%	11.4%	6.3%	13.9%
Margins					
EBITDA margin	18.1%	15.8%	15.7%	15.5%	15.5%
EBIT margin	12.4%	10.0%	10.6%	11.2%	11.6%
Net Profit Margin	13.2%	11.0%	11.1%	11.8%	12.0%
Key Ratios					
ROE (%)	11.4%	11.9%	13.8%	15.0%	16.5%
ROA (%)	8.5%	8.1%	9.8%	10.5%	11.4%
Net Debt/(Cash)	(119)	(314)	(274)	(201)	(234)
Net Gearing (X)	Net Cash	Net Cash	Net Cash	Net Cash	Net Cash

Source: Company Data, PSR est

*Forward multiples & yields based on current market price; historical multiples & yields based on historical market price.

Quarterly Revenue and Profitability data

Fig 1. Revenue (S$ mn)

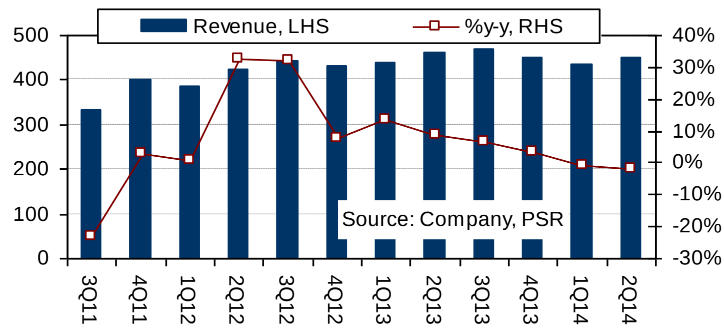


Fig 2. Revenue by Business (S$ mn)

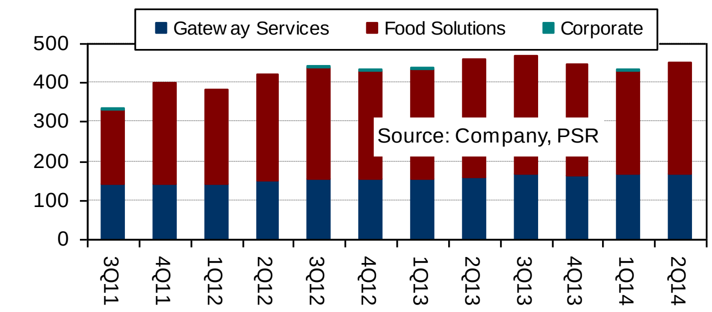


Fig 3. Revenue by Industry (S$ mn)

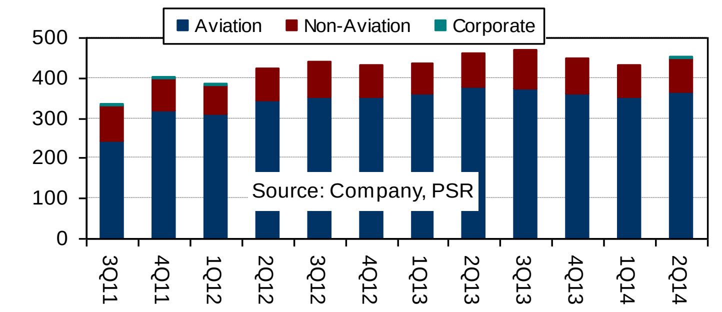


Fig 4. Revenue by Geography (S$ mn)

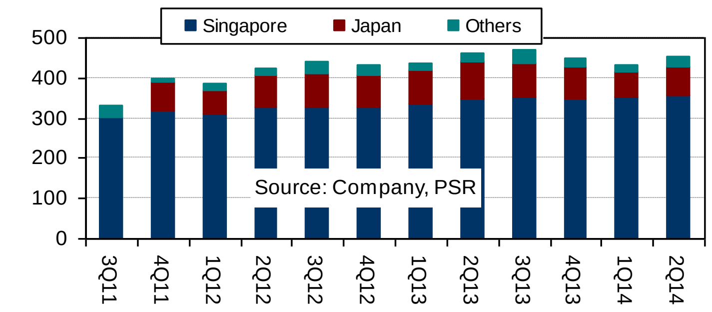


Fig 5. Revenue contribuition from TFK Corp (S$ mn)

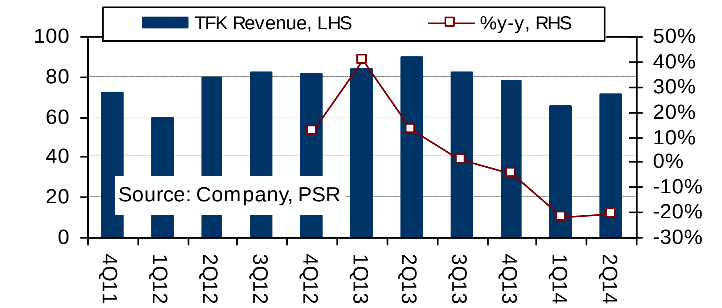


Fig 6. Share of profits from Associates and JVs, net of tax (S$ mn)

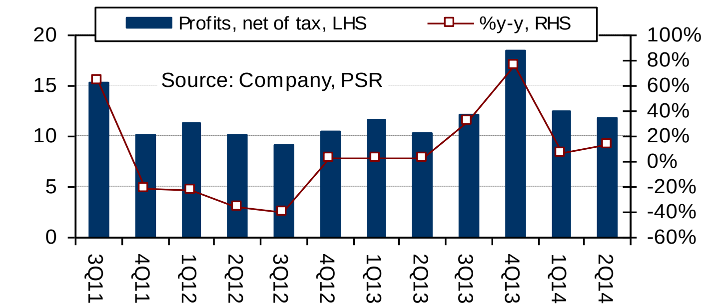


Fig 7. EBITDA trend (S$ mn)

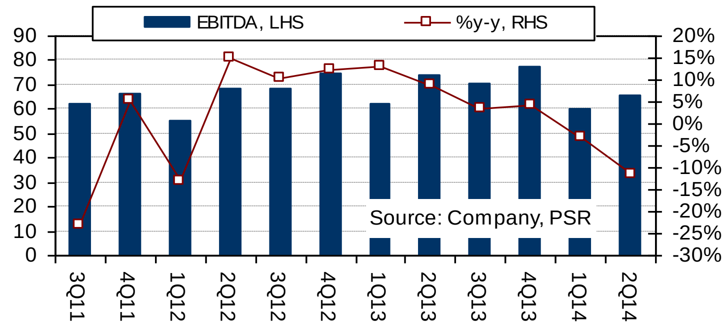


Fig 8. Operating Profit trend (S$ mn)

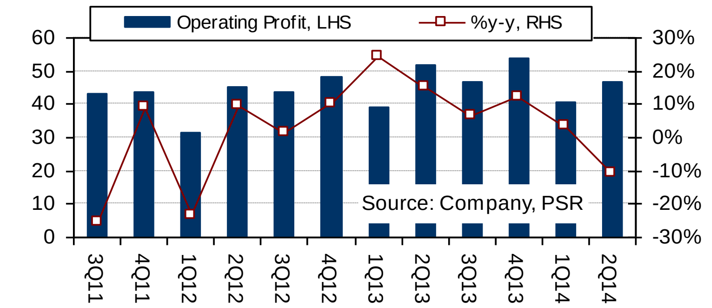


Fig 9. PBT trend (S$ mn)

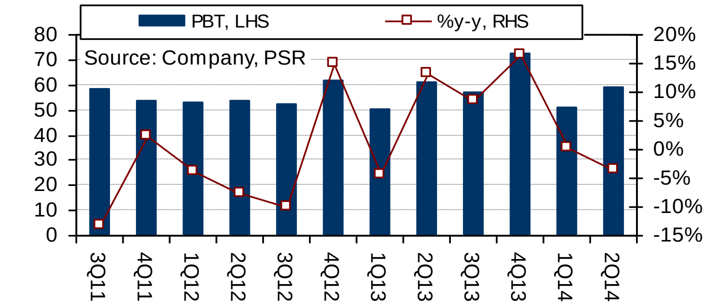
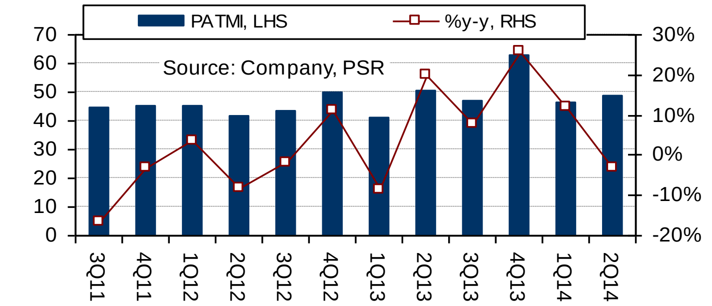


Fig 10. PATMI trend (S$ mn)



Quarterly Financial Indicators

Fig 11. EBITDA Margin Trend

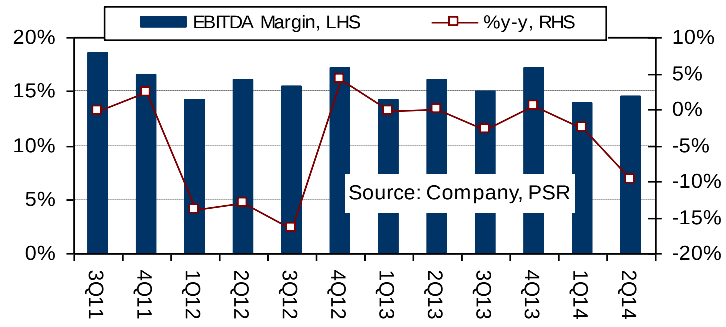


Fig 12. Operating Margin Trend

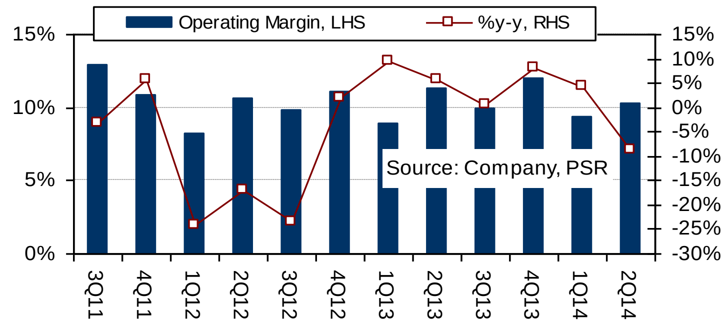


Fig 13. PBT Margin Trend

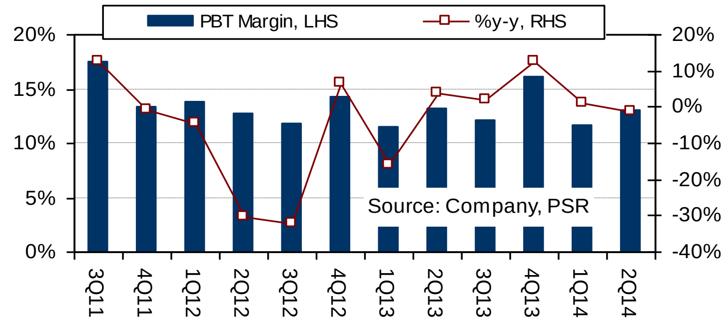


Fig 14. PATMI Margin Trend

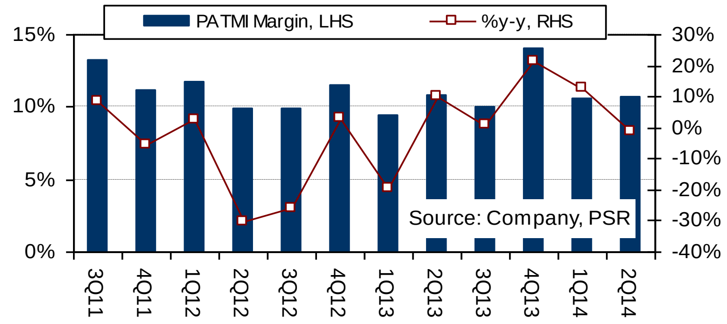
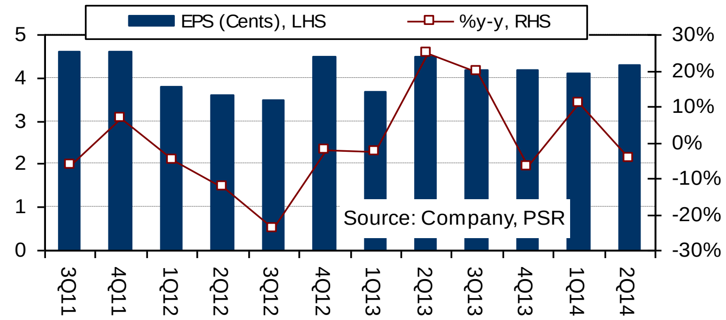


Fig 15. EPS (Cents) Trend



Quarterly Operating Statistics for Singapore Aviation Business

Fig 16. Passengers Handled (mn)

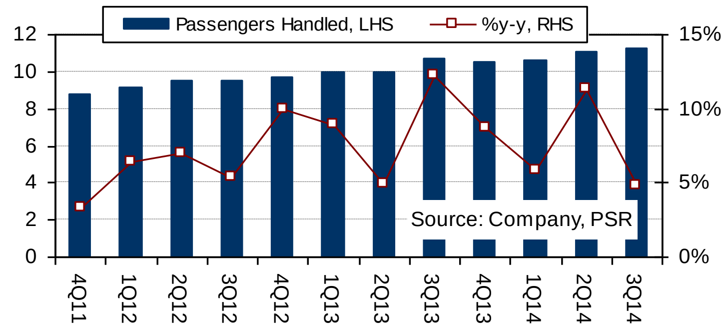


Fig 17. Flights Handled and Unit Services ('000)

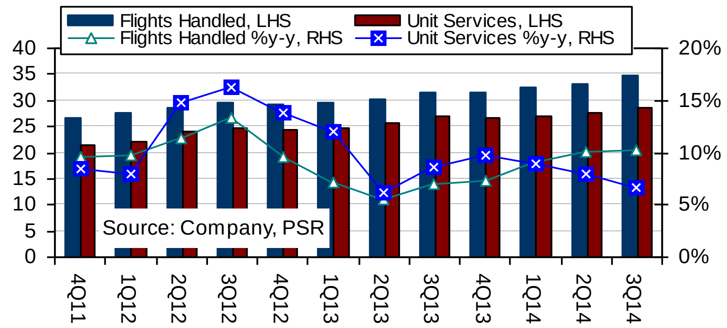


Fig 18. Cargo ('000 tonnes)

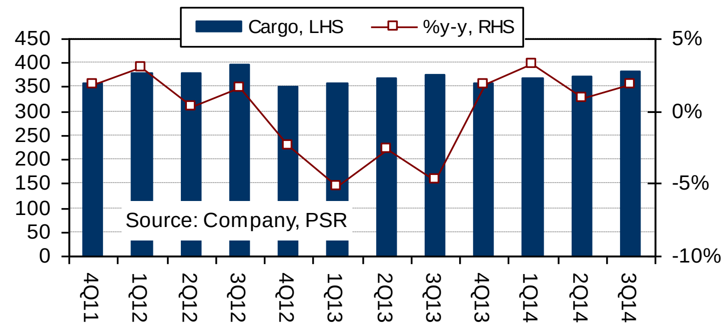
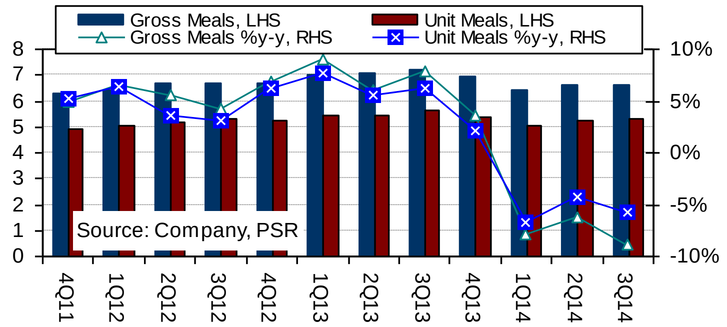


Fig 19. Gross and Unit Meals Produced (mn)



Revenue growth drivers for SATS

Fig 20: Singapore Visitor Arrivals (mn)

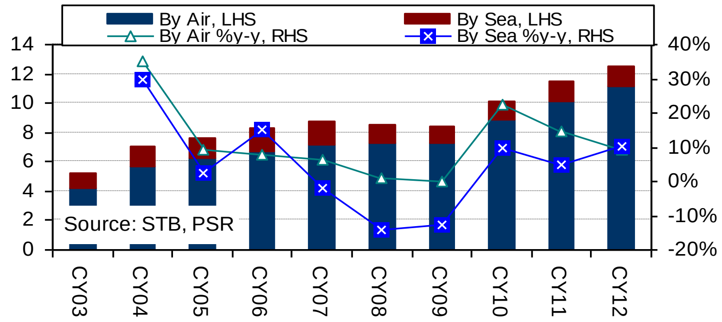


Fig 21: Changi Airport: Passenger Movements (mn)

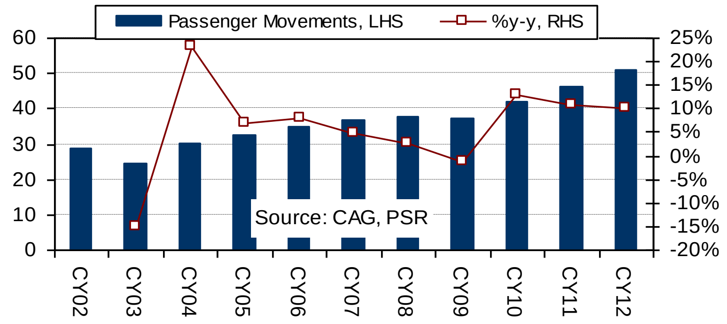


Fig 22: Changi Airport: Air Freight Movements (mn tonnes)

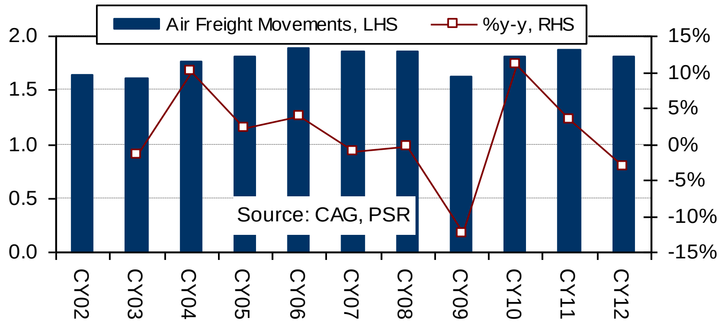


Fig 23: Changi Airport: Commercial Aircraft Movements ('000)

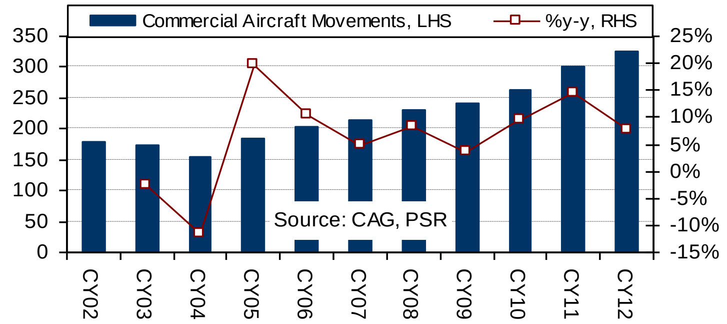


Fig 24: Singapore Cruise Centre: Number of ship calls

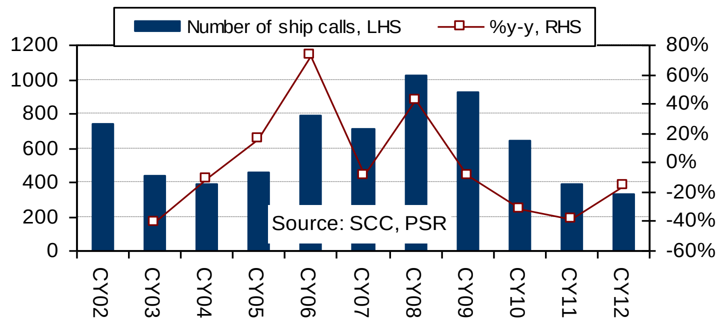
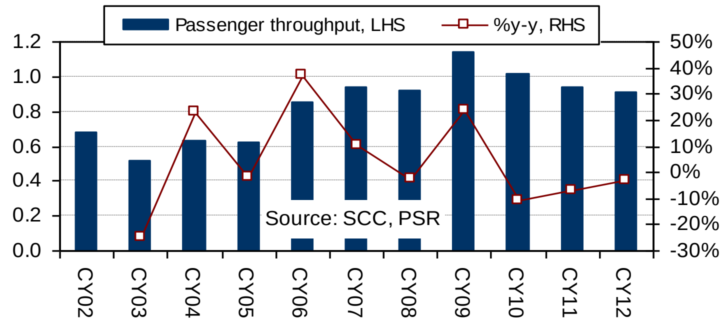


Fig 25: Singapore Cruise Centre: Passenger throughput (mn)



Cost drivers for SATS

Fig 26: CPI: Food excluding Prepared Meals

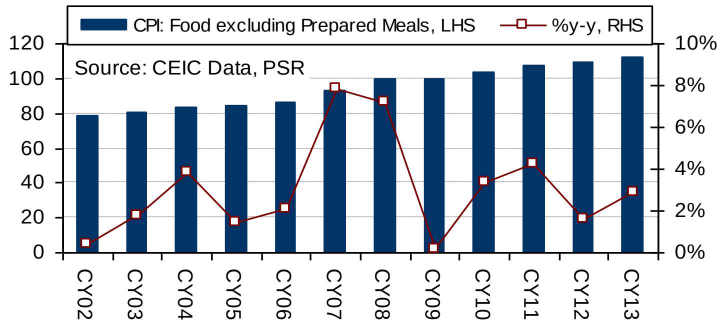


Fig 27: Unit Labour Cost Index

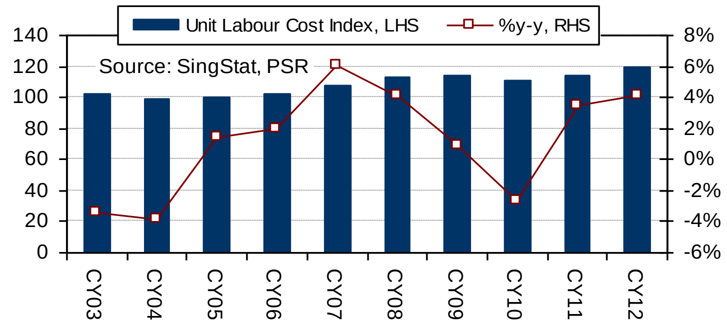


Fig 28: Average Monthly Earnings: Total (S$)

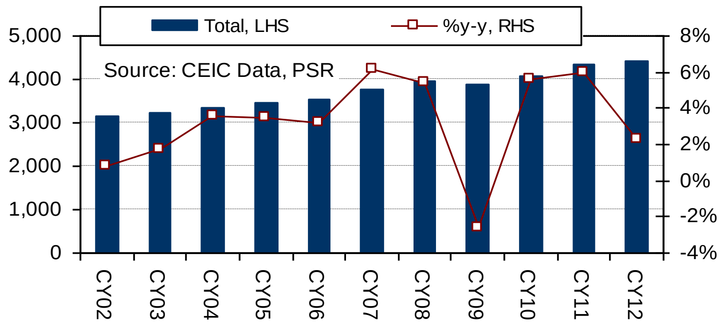
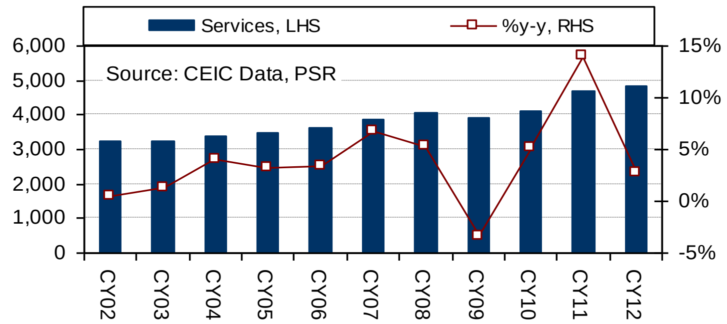


Fig 29: Average Monthly Earnings: Services (S$)



APPENDIX

Company Background

The Company was incorporated in 1972 as a wholly-owned subsidiary of Singapore Airlines (SIA), but traces its origins from the Malayan Airways era since the start of commercial aviation in Singapore in 1947. It provided ground handling services at Paya Lebar Airport as a department of Malayan Airways, which subsequently became Malaysia-Singapore Airlines (MSA), and later came under SIA when MSA split to form SIA and Malaysian Airline System (MAS). Hence, the Company has an operating history of more than 60 years.

SATS was listed on the Singapore Exchange Mainboard in May 2000 and was divested from SIA in September 2009. SIA had divested SATS to concentrate on its core airline and engineering businesses. The Company changed its name in August 2010 from Singapore Airport Terminal Services Limited to SATS Ltd. to better reflect its strategic directions and characteristics.

Today, SATS's core operating businesses are in **Gateway services** and **Food solutions**, and it is the dominant player at Changi Airport with approximately 80% market share. Through its various acquisitions and subsidiaries, SATS has diversified into the institutional catering business, began operating a cruise terminal, and expanded geographically to provide aviation services at various locations around the Asia and the Middle East.

Gateway services – SATS is the main Gateway services provider at Changi Airport and it handled 74% of all flights for the FY ending March 2013. SATS served over 50 airlines, more than 123,000 flights and 41.2 million passengers during that FY. The Gateway services offered at Changi Airport by SATS includes cabin handling (delivering meals, cabin cleaning, waste removal), apron services: ramp handling (loading, unloading, sorting of baggage, cargo and mail), passenger services (check-in facilities, transit lounge, unaccompanied minors, wheelchair passengers) and security (passenger screening, airport security). SATS launched its wholly-owned subsidiary Asia-Pacific Star (APS) in March 2009 to serve the low-cost carrier (LCC) segment at Changi Airport. SATS also operates Coolport@Changi, which is the first perishable handling centre on-site at Changi Airport, with an annual handling capacity of 250,000 tonnes.

Apart from aviation Gateway services, SATS has ventured into the cruise Gateway services business segment. Its wholly-owned subsidiary SATS Airport Services had entered into a 60:40 joint venture with Creuers del Port de Barcelona to manage and operate Marina Bay Cruise Centre (MBCCS), under SATS-Creuers Cruise Services (SATS-Creuers). Operations at the terminal commenced in May 2012 and it is the home port to seven ships. FY2012-13 saw SATS-Creuers handling more than 80 ship calls and over 230,000 passengers during its first year of operations.

Outside of Singapore, SATS has expanded its Gateway services footprint through various subsidiaries, associates and joint ventures. SATS has stakes in various passenger handling and cargo handling facilities in Hong Kong, China, Taiwan, India, Indonesia and Vietnam.

Food solutions – SATS is the main in-flight caterer at Changi Airport and served 85% of all flights for the financial year ending March 2013. It operates two in-flight catering kitchens at Changi Airport, serving both mainline airline carriers and LCCs. The kitchens are able to produce 80,000 meals per day, and had produced 28.3 million meals in the most recent FY ended. As part of a comprehensive in-flight catering service, SATS also provides Research & Development (ensuring highest level of food safety, performing microbiological tests on drinking water, raw materials and finished products, swab tests, hygiene checks, quality audit checks), menu planning (variety of international cuisine, menus refined and tested in Simulated Aircraft Cabins (SAC) for an altitude of 22,000 ft) and culinary training (training cabin crews and staff on planning, preparing and serving international meals).

SATS acquired Singapore Food Industries (SFI) in April 2009 as a wholly-owned subsidiary and SFI was de-listed. Through this acquisition, SATS has mitigated its exposure to the risks associated with the cyclical aviation sector, and leveraged on its existing catering expertise to gain a foothold in the non-aviation institutional catering business. This was primarily through the catering of fresh meals to the Singapore Armed Forces (SAF), hospitals and the Home Team. SFI also produces retort meal bags for the SAF (colloquially known as combat rations). Apart from preparation of meals, SFI is also involved in warehousing and distribution of food products. SATS has also mitigated some of its raw material costs concerns though upward integration with abattoir and hog auction activities via subsidiaries under SFI.

In December 2010, SATS acquired Japan Airline's entire stake of TFK Corporation (TFK) through its wholly-owned subsidiary SATS Investments Pte Ltd (SIPL) for S$122 million. SATS now owns 50.7% of TFK (with voting rights of 53.8%). TFK is the leading in-flight caterer at Narita International Airport and Haneda Airport in Japan. TFK served 12 million meals in the most recent financial year ended. The financials from TFK have been consolidated into with SATS's financial results since the 4Q of FY2010-11.

SATS has expanded its aviation Food solutions footprint outside of Singapore through various subsidiaries, associates and joint ventures. SATS has stakes in various in-flight catering facilities in China, Macau, Taiwan, India, Maldives, Saudi Arabia and Philippines. SATS has also recently ventured into remote catering. It recently won contracts to provide catering and housekeeping services to a barge off Myanmar waters and a jack-up rig in Indian waters.

Management Quality – SATS has a strong team of senior executives overseeing the various business functions within the SATS Group. Many of them each have at least 30 years experience within the Group. The experienced Management Team have proven to have a good understanding of the challenges of the Group and have been able to identify threats and risks. Management had recognised the cyclical nature of the aviation business and have been successful in expanding to non-aviation Food solutions, and more recently to cruise Gateway services. Management had also recognised rising labour costs and took steps to automate processes to improve productivity. Despite rising food costs and labour costs, Management has been successful in keeping Staff costs and Cost of raw materials to about 42% and 22% of Revenue respectively over the last three FYs.

The outgoing President/CEO, Tan Chuan Lye has retired at the end of 2013. He led the SATS Group for 2 years and served within the Group for 36 years. He will remain within the Group, continuing his role as Executive Vice President, Food Solutions.

The incoming PCEO, Alexander Hungate has been non-executive director since July 2011. He has served on the Remuneration and Human Resource Committee and Nominating Committee. His most recent role was HSBC Group General Manager and CEO Singapore. He has 25 years of global experience and brings to the table his expertise in global financial, strategic and people development.

Market structure and industry analysis

Gateway services

The Gateway services market in Singapore is characterised by high barriers to entry. This is because the operator requires a licence to provide the service, as in the case for both the aviation and cruise segments. In addition, there is high start-up costs associated with aviation Gateway services for the specialised equipment used in ground handling. The industry life cycle has reached the mature stage, with consolidation of the players to an oligopoly for the aviation segment and soon converging to a monopoly for the cruise segment. With the low number of players offering Gateway services, the market concentration is high. In the case of the aviation Gateway services segment, SATS holds approximately 74% of the market share at Changi Airport, with the other competitor, dnata, holding the rest. Being the market leader, SATS has an advantage in terms of ability to be a price setter. Although there are no substitute products for Gateway services, but the players themselves offer good equivalent substitutes to one another with little product differentiation. There is customer stickiness in this market and it is unlikely existing customers will switch away from SATS. Competition is not intense, in the sense that both players at Changi Airport are not aggressively under-cutting one another in price. The demand for Gateway services is highly sensitive to the business cycle and categorised as a cyclical industry. Growth of the Gateway services business is also highly dependent on Government influence; relying on the Government to spend money on relevant infrastructure.

Aviation Food solutions – The Aviation Food solutions market in Singapore is effectively in-flight catering at Changi Airport. The market structure is an oligopoly with two players supplying in-flight catering solutions. The industry has reached the mature stage of the industry life cycle. The market concentration is high, with SATS holding 85% of the market share. Barriers to entry are high, as a licence is required in order to offer in-flight catering. Large start up costs is involved in setting up a large in-flight kitchen to cope with the large volume of meals demanded. The competitive advantage that SATS possess in the aviation Food solutions is its long-standing operating history and it serves a stable of reputable airlines. Competing airlines are keen to provide equal if not better in-flight meals than their competitors. Hence, there is a tendency for other airlines to engage SATS because the leading airlines are supplied by SATS. The demand for aviation Food solutions is highly sensitive to the business cycle and categorised as a cyclical industry. Growth of the aviation Food solutions business is also highly dependent on Government influence; relying on the Government to spend money on relevant infrastructure to spur air travel.

Non-aviation Food solutions – The market structure of the non-aviation Food solutions segment is between a perfect competition and an oligopoly. The Food solutions industry has reached the mature stage of the industry life cycle. It is highly fragmented with many players offering many substitutes with differentiated products. However, SATS has positioned itself to serve the institutional catering segment of the Food solutions industry. Hence it is operating where there are only a few players. Supplier concentration and customer concentration are both high in this segment. The nature of the institutional catering segment is less sensitive to the business cycle, hence it is less cyclical. On the other hand, the catering of Meetings, Incentives, Conventions and Exhibitions (MICE) events would be somewhat sensitive to the business cycle. Consequently, Government influence does play a part in this industry, as it relies on Government initiatives to attract MICE events to choose Singapore as the venue.

Porter's Five Forces Analysis for SATS

Threat of new entrants – low to moderate

There is a high barrier to entry for the aviation industry that SATS operates in. It requires specialised equipment, trained staff to operate the equipment and significant investment required to set up a catering facility in close proximity to the airport. In addition, there is a natural barrier to entry as a licence is required, in order to provide aviation Gateway services at Changi Airport. The licence can be obtained only if the aviation Authority opens a tender. This usually comes with stringent requirements, and competition to obtain the licence is keen.

Threat of new entrants for the non-aviation Food solutions business is low, specifically to the institutional catering segment, as it requires substantial investment in facilities, industry experience, and distribution network to deliver the volume of meals associated with institutional catering. New entrants to the institutional catering segment would need to rapidly capture a share of the existing market, in order to realise sufficient operating economies of scale. However, it would be unlikely for consumers to contract large catering requirements to a new entrant with no track-record.

Although SATS is converging towards holding a monopoly over the provision of cruise Gateway services in Singapore, but its real competitors come from outside of Singapore in the form of other ports and cruise terminals. The threat of new entrants for cruise Gateway services is moderate. The various ports in the region would be aware of the economic benefits of operating a successful cruise terminal and would want to establish a competing cruise terminal. However, it takes substantial investment and time to build up the required infrastructure. The current two leading cruise terminals in the region are Singapore and Hong Kong, while China has been ramping up its cruise terminal developments.

Threat of substitutes – low to moderate

For aviation Gateway services and aviation Food solutions, there are effectively only two players at Changi Airport. There are no substitute products for Gateway services or Food solutions. However, the characteristic of the aviation industry has evolved, reflected by the rise in low cost carriers (LCC). This does pose a threat to the demand for Food solutions. Meals are not included in fare prices on LCCs and their routes are predominantly short-haul.

Threat of substitutes for non-aviation Gateway services is low to moderate. SATS is converging towards the monopoly operator in Singapore, but will face increasing competition from other ports in the region. Other destinations within the region may lack the modern conveniences that Singapore offers, but can appeal to holiday makers looking for an exotic experience.

Threat of substitutes for non-aviation Food solutions is low. The Food solutions market is large and fragmented with many substitutes, but SATS has taken a position in the institutional catering segment of the market. However, the threat of substitutes is low, specific to institutional catering.

Intensity of rivalry – low

Intensity of rivalry in the aviation Gateway services and aviation Food solutions for SATS is low. There are only two players in the market, and they are not aggressively driving their prices down to compete for market share.

Intensity of rivalry in the non-aviation Food solutions business is low, as there are not many players who can compete with SATS on catering contracts for large scale events. In addition, SATS has established a foothold in the institutional catering segment. SATS has an extensive distribution network of specialised vehicles, thus able to compete for major food contracts

Intensity of rivalry for cruise Gateway services is currently low to moderate. Rivalry comes from outside of Singapore, from other ports and cruise terminal operators. At the moment, Singapore is aggressively attempting to make use of first mover advantage to gain a foothold in this area and entice ships to make Singapore the home-port, before other ports in the region get the appropriate facilities in place.

Bargaining Power of suppliers – moderate

The main inputs to the SATS business are food and labour. SATS is currently facing increasing food costs and labour costs, which are making up a larger percentage of its operating costs. The SATS aviation Gateway services business in particular, is labour intensive. Most of SATS's workforce from the aviation industry are unionised, and would be able to exert some extent of bargaining power. SATS has mitigated some of its food cost concerns through upward integration of the business by going into abattoir and hog auction activities. SATS has also tackled its labour costs, by investing in technology to improve work efficiency.

Bargaining Power of customers – moderate

The bargaining power of customers for aviation Gateway services and aviation Food solutions is low. There are only two market players for customers to choose from; and SATS holds the dominant market share with the ability to be a price setter. At the same time, there are many customers in the industry and hence there is low buyer concentration. Despite its competitor being able to offer a good substitute to SATS with little product differentiation, but the nature of the operations at the airport results in customer stickiness. There is a high switching cost associated with changing the service provider. Airlines would be reluctant to switch service provider as it would entail the new ground handling staff having to learn the airline's operating procedure.

For the non-aviation Food solutions business, SATS operates in the institutional catering segment. SATS has been able to leverage on its in-flight catering experience in supplying large volume of meals to grow this business segment. There is an absence of other caterers with a proven track record for customers to choose from. As such the bargaining power of customers is low.

For cruise Gateway services, SATS is still in the infancy of building up its brand name in this particular business segment. At moment, bargaining power of customers is high as they are free to choose to call at any port with a suitable cruise terminal.

SWOT Analysis

Strengths

- Dominant presence at Changi Airport with the ability to be a price setter.
- Long-standing expertise in large-scale food catering and therefore able to compete for major food contracts.
- Cash rich, thus able to expand through inorganic growth and serve existing customers at new geographic locations.

Weaknesses

- Labour-intensive business with unionised workforce.
- Inorganic growth possible only through partnership with an existing licence holder.

Opportunities

- Robust growth in regional aviation traffic.
- Expanding to serve LCC outside of Singapore.
- Expansion of cruise Gateway services outside of Singapore through partnerships.

Threats

- Inability to renew operating licence.
- Significant exposure to cyclical aviation industry.
- Vulnerable if carriers choose to by-pass Singapore in favour of other air-hubs in the region.
- Natural disasters, civil and political unrests can disrupt air-routes and food production supply-chain.

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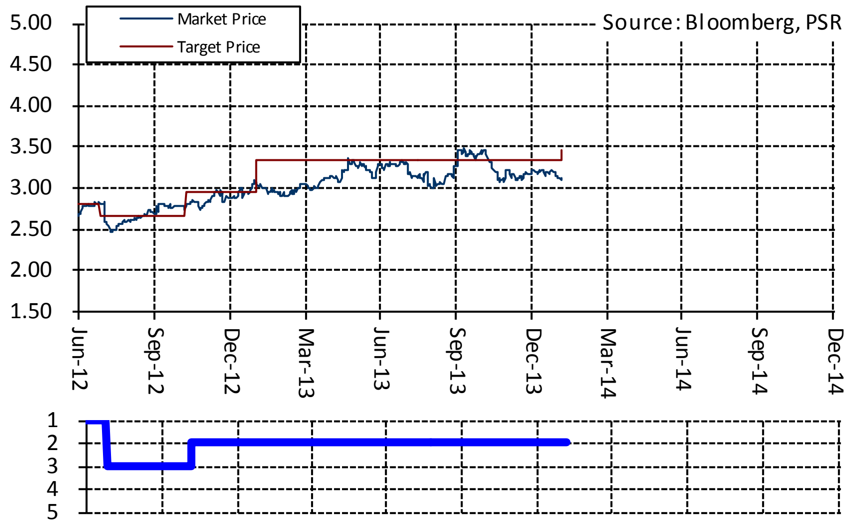
Ratings History



PSR Rating System

Total Returns	Recommendation	Rating
> +20%	Buy	1
+5% to +20%	Accumulate	2
-5% to +5%	Neutral	3
-5% to -20%	Reduce	4
< -20%	Sell	5

Remarks

We do not base our recommendations entirely on the above quantitative return bands. We consider qualitative factors like (but not limited to) a stock's risk reward profile, market sentiment, recent rate of share price appreciation, presence or absence of stock price catalysts, and speculative undertones surrounding the stock, before making our final recommendation

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